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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Inflation Fears Reawaken Worldwide

What a difference six months make! Last December, the dollar was trading at record lows against most major currencies, prompting sizable coordinated central bank intervention to prevent the "greenback" from falling even further. At the same time, most economists and currency traders, concerned by both the lack of progress being made in correcting the global trade imbalances—especially the U.S. trade deficit—and the display of confrontation among the leaders of the major industrial countries, were projecting new lows for the dollar by the end of this year. As a result, such international agencies as the Organization for Economic Cooperation and Development (OECD), government officials, and private economists were busy revising their GNP forecasts; the effects of the plunging dollar and the October stock market crash were supposed to induce a recession here and sharply lower economic growth rates abroad. Trying to avoid a global economic turndown had plainly become the chief economic priority of the major industrial nations.

Manufacturers Hanover Economics Department 17/270

Now, a half-year later, buoyed largely by two consecutive months of better-than-expected U.S. trade figures and rising U.S. interest rates, the dollar has risen beyond DM 1.82/$, more than 27 pfennigs above its early January lows and the highest against the Deutschemark since October. At the same time, the dollar has pierced the Yen 133/$ level, more than ten percent stronger than it was at the start of this year (see chart). What's more, not only did a global economic turndown fail to materialize, but economic growth in the industrial countries has seemingly become so strong that it has reawakened inflation fears worldwide, thereby prompting a trend toward higher interest rates in the major financial centers.

Interest Rates Rise

Although Germany's inflation rate is currently barely more than one percent (year-over-year), it has climbed steadily in recent months, reaching its highest pace since 1985. Thus, with the German economy growing much stronger than expected—real GDP increased by an annualized rate of six percent in the first quarter—the money supply expanding considerably above target, and the weakness of the Deutschemark beginning to place upward pressure on import prices, the Bundesbank last month took advantage of the dollar's strength and higher U.S. interest rates to raise its chief money market interest rate by a ¼ percentage point to 3.5 percent and its discount rate by a ½ percentage point to three percent.

U.S. DOLLAR VS. DEUTSCHEMARK (THICK) AND JAPANESE YEN (THIN) (WEEKLY AVERAGES)

While fears of inflation are probably exaggerated in Germany, they may have more of a basis in the United Kingdom. Buoyant economic growth, reflecting excessive wage increases, above-target money supply expansion, and hefty bank lending, triggered a jump in the inflation rate to 4.2 percent in the 12 months ending in May, almost a full percentage point higher than it was in January. In an attempt to cool off the economy, the Bank of England last month engineered four half-point increases in the British base lending rate, bringing it to 9½ percent.

Vigorous economic growth has also begun to produce some inflation concerns in Japan. While consumer prices are stable now, the Japanese economy grew by an inflation-adjusted 11.3 percent (annualized) in the March quarter, its highest growth pace in 11 years. What's more, the country's money supply has been increasing at a robust pace of more than 10 percent since May of last

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year. Thus, although higher interest rates have yet to be formalized by the Bank of Japan, its Treasury bill rates are nudging upward and may well rise further.

The Dollar Rallies

The increase in interest rates abroad, especially in Germany, is unlikely to precipitate a plunge in the dollar the way that it did last autumn. One reason is that interest rates have already been rising here. The Federal Reserve has tightened monetary policy in the United States on three separate occasions since April; the widening differential between U.S. and German rates has clearly given the Bundesbank room to tighten its own monetary policy.

Second, this time, the Bundesbank increased its interest rates in a spirit of cooperation with the other G-7 nations. This was not the case last October, when an increase in German interest rates triggered sharp criticism from U.S. Treasury Secretary Baker. It was this clash, more than the increase in German interest rates itself, that unnerved the markets, triggering the stock market crash and subsequent dollar selloff.

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/15/88)	182,726	+ 387	+ 10,618
New York City (6/22/88)	37,767	+ 417	+ 1,466
Commercial Paper (6/22/88)	416,162	+ 2,223	+ 61,506

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/15/88)	300,602	+ 703	+15,462
New York City (6/22/88)	57,552	– 570	– 2,232

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/15/88)	897,449	– 9,245	+61,161
New York City (6/22/88)	174,952	– 6,604	– 1,023

Financial Markets

	Friday 7/1/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.73%	+ .04	+ .17
180-Day Bills†	7.00	– .07	–0–
Longest Bills†	7.48	– .02	+ .03
Recent Issues:			
8S 6/30/90	7.93	– .07	
81/4S 6/30/92	8.25	– .08	
9S 5/15/98	8.74	– .09	
91/8S 5/15/18	8.81	– .04	
Municipals:			
Bond Buyer–20 Bond Index* (6/30/88)	7.74%	– .03	– .07
Blue List Total ($ Million)	$1,397	– $ 113	–$ 384
30-Day Visible Supply ($ Million)	$1,484	+ $ 438	–$ 562
Total	$2,881	+ $ 325	–$ 946
Corporates:			
Moody's Aa Composite (6/30/88)	10.10%	+ .03	+ .50
30-Day Visible Supply ($ Million)	$2,000	– $2,291	–$2,472
Stocks:			
****Dow-Jones Averages:**			
Industrials	2,134.96	– 8.00	–301.74
Transportation	902.63	+ 3.74	–127.80
Utilities	180.65	– 1.01	– 25.25
65 Stocks	798.41	– 1.47	–114.36
N.Y.S.E. Composite Index	154.43	– .13	– 17.40
N.Y.S.E. Avg. Daily Vol. for Week (000's)	201,672	+ 29,804	+46,496

*34% Taxable equivalent 11.73%.
**As of 2:30 p.m.
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/1/88	Week Ago
Overnight	7.63%	7.38%
1 month	7.69	7.56
3 month	7.75	7.63
6 month	7.88	7.75
1 year	8.13	8.13

FOREIGN EXCHANGE SPOT RATES

New York Opening (7/1/88)	Currency Per U.S. $	Week Ago
Belgium	38.12	37.60
Canada	1.2134	1.2058
France	6.1440	6.0470
Germany	1.8180	1.7960
Italy	1353.50	1332.00
Japan	134.95	129.85
Mexico	2273.00	2273.00
Netherlands	2.0490	2.0045
South Korea	728.40	728.70
Switzerland	1.5115	1.4960
Taiwan	28.89	28.74
U.K.*	1.7020	1.7455

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (7/1/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/8
	+1.7%	–3.0%

Third, significantly better-than-anticipated U.S. trade figures both in March and in April have reassured, if not convinced, the foreign exchange markets that the U.S. trade deficit is being reduced, slowly but surely. Eight months ago, little evidence was in sight, at least in dollar terms.

Finally, and perhaps most important, the combination of higher U.S. interest rates, the improving trend in the U.S. trade deficit, the still healthy performance of the U.S. economy and the apparent tolerance by the Federal Reserve of a stronger dollar has turned market sentiment sharply in favor of the U.S. currency.

As a result, not only does there appear to be little risk of a dollar selloff at the moment, but, despite the increase in German interest rates and hefty forex intervention by the Bundesbank (the central bank has spent more than $5 billion since late May to stem the greenback's rise), the dollar is likely to advance further—at least until the other G-7 central banks give the markets clear indication that they, too, feel it's gone high enough. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

Reserve Bank Credit	Week Ending 6/29/88	$ Change Since Week Ago	$ Change Since Year Ago
U.S. Gov'ts and Agencies Owned Outright & RPs	234.836	+ 2.613	+10.651
Loans to Depository Inst.	2.281	− .753	+ 1.393
Float	.545	− .326	− .210
Total Reserve Bank Credit	252.653	+ 1.667	+10.859
Treasury Deposits with Federal Reserve Banks	6.529	+ 2.277	− 9.032
Currency in Circulation	233.267	− .115	+18.693
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	226.364	− 4.851	−48.556
	6/29/88		
Member Bank Reserves:			
Total Reserves Held	60.417	− .565	+ 3.249
Excess (Deficiency)	1.105	+ .412	− .515
Net Free Reserves	.558	+ .344	− .495

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (6/20/88)	778.6	+ 7.5	+ 4.1
M2 (6/20/88)	3,018.4	+ 7.1	+ 5.7
M3 (6/20/88)	3,803.3	+ 6.6	+ 6.0
Domestic Nonfinancial Debt (1st Q'88)	8,541.7	+ 8.2	+ 9.3

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/1/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	6.55%	6.71%	7.00%
* Federal Agencies	7.34	7.38	7.45
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.20	7.42	7.73
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.68	7.78	7.95

‡ Finance Company Paper—Prime

5- 14 days	7.40%
15- 29 days	7.45
30- 59 days	7.50
60- 89 days	7.53
90-179 days	7.51
180-239 days	7.50
240-270 days	7.50

‡* Bankers' Acceptances

Aug.	7.48%
Sep.	7.48
Oct.	7.51
Nov.	7.51
Dec.	7.51
Jan.	7.51

‡ Industrial Paper—Prime

30- 89 days	7.53%
90-120 days	7.55

† Federal Funds Effective Rate 7.69%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'88	$ 4,665r	$ 4,607	$ 4,378
Gross National Product (1982 Dollars)*	1st Q'88	$ 3,915r	$ 3,881	$ 3,772
Percent Change, Annual Rate	1st Q'88	3.6r	4.8	4.4
Change in Consumer Prices*	May '88n	3.6%	4.8%	4.8%
Change in MH Cost of Living Index	May '88n	4.8%	9.6%	4.8%
Change in Producer Prices*	May '88	6.0%	4.8%	2.4%
Civilian Employment (Thousands of Persons) †	May '88	114,195	114,713	112,334
Unemployment as % of Civilian Labor Force †	May '88	5.6%	5.4%	6.3%
Personal Income*	May '88n	$ 3,954	$ 3,941r	$ 3,709
Leading Indicators Composite Index (1967=100) †	May '88n	192.6	192.8r	188.6
Industrial Production Index (1977=100) †	May '88	136.0	135.5	128.2
Net Change in Consumer Installment Credit †	Apr '88	$ 3.65	$ 5.19	$ 4.62
U.S. Merchandise Trade Balance †	Apr '88	−$ 9.89	−$ 11.70	−$ 13.24
Plant and Equipment Expenditures*	3rd Q'88	$438.22(a)	$429.01(a)	$393.13
Private Housing Starts (Thousands of Units)*	May '88	1,384	1,576	1,599
New Construction Expenditures*	May '88n	$ 407.1	$ 402.7r	$ 396.7
Total Business Inventories †	Apr '88	$ 723.7	$ 720.1	$ 670.9
Total Business Sales †	Apr '88	$ 478.8	$ 479.7	$ 445.1

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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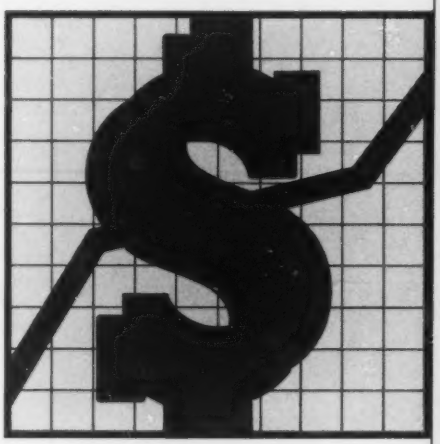

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